No. 86552-3

SUPREME COURT
OF THE STATE OF WASHINGTON

In re:

BOND ISSUANCE OF GREATER WENATCHEE
REGIONAL EVENTS CENTER PUBLIC FACILITIES DISTRICT

* * * * *

GREATER WENATCHEE REGIONAL EVENTS CENTER PUBLIC FACILITIES DISTRICT,

Appellant,

v.

CITY OF WENATCHEE, WASHINGTON,

Respondent.

ANSWER OF APPELLANT TO BRIEFS OF AMICUS CURIAE

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I. INTRODUCTION

Amicus curiae Washington State Treasurer ("Treasurer") and the City of Vancouver, Washington ("Vancouver") (collectively, "Amici") agree with Appellant Greater Wenatchee Regional Events Center Public Facilities District ("District") on the fundamental legal framework that governs this case:

- Both Amici agree that, in Washington, "debt" is defined as *borrowed money.* (Treasurer Br. 8; Vancouver Br. 10).
- Both also agree that, in Washington, a contingent obligation is not a "debt." (Treasurer Br. 11-12; Vancouver Br. 10).
- Neither challenges the fundamental proposition that "debt" is created only if the borrower pledges its future general tax revenues for repayment of the debt.
- Both Amici agree that, for Washington municipalities, only principal, and not unearned interest, is included in the "debt" counted against constitutional and statutory debt limitations. (Treasurer Br. 15; Vancouver Br. 17)

Amici focus their arguments on the law concerning contingent liabilities.[1] Amici suggest that the District's economic situation requires this Court to reformulate Washington law concerning contingent obligations. But there is no need to craft a new test. This Court's existing jurisprudence provides a clear answer to whether the City's obligation to

[1] There is no reason to decide the issues related to contingent obligations because the City's contingent obligation is not "debt" because it is not borrowing, and also because the City has not pledged its future tax revenues to repayment of the debt. This is true whether or not the City's obligations are contingent.

make loans in this case is contingent: If the conditions triggering an obligation have not yet occurred, the obligation remains contingent. Both Respondents have conceded that there no way to estimate either the timing or amount of loans the City might be required to make. The City's obligations, therefore, remain contingent under the relevant legal test.

Vancouver suggests that the Court adopt a new test for determining whether a contingency exists – whether it is "reasonably certain" or "reasonably likely" that the contingent obligation will be triggered. But Vancouver's argument is an invitation to endless litigation, because it would substitute this Court's clear test for an ambiguous one. There is simply no clear and predictable test for determining when a contingent obligation is "reasonably likely" to be triggered. And, as the Treasurer properly points out, clear and easily-applied rules are critical to support efficient and economical government financing.

The Treasurer, on the other hand, proposes what is effectively a new legislative requirement that a municipality contemplating a Contingent Loan Agreement make a determination at the outset as to whether it would be obligated to make any loans and, if so, how much. Although no such legal principle was in effect when the City first agreed to provide contingent loans to the District in 2006, the record shows that

such a determination was made and that the City's contingent obligations therefore would not be "debt" even under the Treasurer's proposed test.

II. ARGUMENT

A. Washington Law On Contingent Obligations Is Clear.

As the District has established, and Amici agree, Washington law makes a clear distinction between obligations that have matured and obligations that are contingent only. Contingent obligations are not "debt" under Washington law. Further, Washington law is clear that a contingent obligation remains contingent until the contingency is triggered. Brief of Appellant ("App. Br.") at 33-39; *Comfort v. City of Tacoma,* 142 Wash. 249, 256-57, 252 P. 929 (1927) (an obligation is contingent unless there is a "duty to pay *without regard to any future contingency*") (*citation omitted*). In short, a contingent obligation remains contingent – and not "debt" – until the contractual conditions required to trigger the obligation occur.

Washington law also provides clear guidance as to the primary question posed by the Treasurer: if the City was required to make loans, at what point would the City assume "debt"? *Comfort* again provides the answer – even if the City's loan obligations are triggered, the City will not assume "debt" unless it elects to borrow to fund those loans. *Comfort* involved Tacoma's guarantee of payments on Local Improvement Bonds,

where assessments on property owners were the primary source of repayment. As this Court concluded, even if Tacoma had been required to make good on its guaranty and to make payments on the Bonds "by reason of the property owners' failure to pay," no "debt of the city as that term is used in construing the constitutional limitation" would be created because Tacoma was funding its guarantee obligation through current-year taxes. "It is well-recognized legal principle that those obligations, which, as soon as they become such, are provided for by taxation for the current year are not to be included in the debts that are taken into consideration in determining the . . . constitutional limit." 142 Wash. at 257.

Accordingly, the answer to the questions posed by Amici is clear: The City's contingent obligations remain contingent unless and until the contractual contingencies to those obligations ripen. And even if the City's obligations are triggered and it is required to make loans under the Contingent Loan Agreement, the City would still not incur "debt" in the constitutional sense unless it elects to fund those loans by issuing new bonds of its own or otherwise borrowing money. As long it funds the loans from current-year tax revenues or from other sources not requiring borrowing, it has not taken on "debt." *See* App. Br. 26-29; CP 455 (App.

A at § 1.01(c)) (allowing the City at its discretion to fund loans from current taxes, new debt, or any other available source).[2]

It is clear under this test that the City's obligation to make loans under the Contingent Loan Agreement remains contingent. As the City has conceded, it "simply does not know how much or at what time" obligations might be incurred under the Contingent Loan Agreement. (CP 751 n. 32). Further, as the record, including the plain language of the contracts, makes clear, the City will be required to make loans at future semi-annual intervals only if the funds available to the District are insufficient to meet the next upcoming semi-annual debt service payment. App. Br. 11-12.[3] Nor is the City required to issue its own new debt to fund the loans. CP 455 (App. A § 1.01(c)). Hence, the City's obligations are contingent under the relevant legal test. Vancouver's claim (Vancouver Br. 13) that any City loans are "not really" contingent – the underpinning for its argument – is incorrect.

To support its argument that any loans the City might be required to make are not contingent, Vancouver attempts to distinguish *Comfort*

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[2] A copy of the Contingent Loan Agreement is attached as Appendix A to the Brief of Appellant. "App. A." references that appendix.

[3] Vancouver, like the Respondents, cites to language in the Contingent Loan Agreement describing the City's obligations as "absolute and unconditional." (Vancouver Br. 5). But, like Respondents, Vancouver ignores the fact that the City's "absolute and unconditional" obligation will not arise until the contractual contingencies in the Contingent Loan Agreement are satisfied. *See* Reply Br. of Respondent at 22-23.

from this case, but its arguments are without merit. Vancouver argues (Vancouver Br. 11-13) that the City's potential obligations are not limited to a particular fund, as in *Comfort*. But *Comfort's* holdings concerning contingent obligations depend on whether the specified contingencies are triggered, not on the source of funds that would be tapped should the contingent obligation become a mature obligation. 142 Wash. at 255-57.

Vancouver' argument is also premised on the assertion (Vancouver Br. 8-9) that the Contingent Loan Agreement should be characterized as a guaranty rather than a loan. Even if that were true, the argument is irrelevant. Washington law – starting with *Comfort,* which involved a guarantee and not a loan (142 Wash. at 254-55) – is clear that a guarantee is a contingent obligation until the conditions requiring payment of the guarantee are triggered. *Id.* at 256; *State ex rel. Washington Toll Bridge Authority v. Yelle,* 56 Wn.2d 86, 94-96 351 P.2d 493 (1960) (where amount to be placed in guarantee fund depends on future developments, "the guaranty is only a contingent liability" and contingent guarantee therefore does not violate constitutional debt limitations).

In any event, Vancouver's "guaranty" argument is incorrect. The Contingent Loan Agreement requires the District to repay any loans made by the City with interest, and it is therefore a loan, not a guarantee. *See* App. Br. 12-13. And, contrary to Vancouver's assertions (Vancouver Br.

at 13), the City's loans are secured. The Contingent Loan Agreement gives the City (in conjunction with the District's other municipal members) the right to require the District to raise its taxes and, if the District's debt limitations are exhausted, requires the District to transfer a tenancy-in-common ownership interest to the City. *See* App. Br. 13-14. If necessary, the City can enforce this interest in essentially the same manner as any other secured property interest. *See United States v. Ohmdahl,* 104 F.3d 1143 (9th Cir. 1997) (construing Washington law to allow foreclosure upon mortgage secured by tenancy-in-common ownership); *Clallam County v. Folk,* 130 Wn.2d 142, 148-49, 922 P.2d 73 (1996) (citations omitted) (a tenancy-in-common interest can be conveyed separately and pledged as collateral). And even an unsecured loan to a debtor that becomes unable to repay is still a loan, not a guaranty.

B. Vancouver's Argument for a "Reasonably Certain to Occur" Test Should be Rejected.

Based on the incorrect premise that this Court's decisions concerning contingent liabilities fail to provide a "bright line" standard, Vancouver proposes that this Court should adopt a new test asking whether a contingent liability is "reasonably certain to occur" or "reasonably likely to occur." (Vancouver Br. 15-16 & n. 23). Vancouver, however, points to no authority supporting its new test. Furthermore,

Vancouver's proposal would produce legal uncertainty, which is particularly problematic in the area of municipal finance.

Vancouver would have this Court overturn Washington's well-developed jurisprudence, which has for more than a century provided a clear, bright-line standard – a contingent obligation remains contingent until it is triggered. Instead, courts would be asked to determine whether a contingency is "reasonably certain" or "reasonably likely" to occur. But Vancouver suggests no standards by which Courts should determine whether contingencies that have not yet been triggered are, nonetheless, "reasonably certain" or "reasonably likely" to occur. For example, Vancouver offers no suggestion as to how the test would be applied to the City's loan obligations that might arise ten years or twenty years in the future, and how a Court might reasonably distinguish between obligations that would trigger Vancouver's test and those that would not.

These flaws are fatal to Vancouver's suggestion. As the Treasurer points out, clear and reliable legal rules are especially critical in the area of municipal finance because investors and municipalities alike rely on clear, bright-line legal standards, and legal uncertainty creates risks that drive up the cost of borrowing. (Treasurer Br. 7). This Court should reject Vancouver's argument because it introduces unreliability and uncertainty into a heretofore clear and easily-applied body of Washington law.

C. **The Treasurer's Argument Lacks Support In the Law, and, In Any Event, Is Met in the Circumstances Presented Here.**

The Treasurer takes a different approach, suggesting that this Court apply a new, two-pronged test to determine whether a debt is "truly contingent," a test that would require: (1) the Contingent Loan Agreement to be an "arm's length" transaction; and, (2) the entity making the loan to make an up-front determination of the extent to which it might be called upon to make loans. (Treasurer Br. 13-17). There is nothing in current law that would require such a result, and the Treasurer cites to no authority to suggest that either the District or the City was required to satisfy either test at any time relevant to this appeal. In fact, as the Treasurer correctly points out, there has never been a Washington case holding that the debt of one municipal entity may be counted as the debt of another municipal entity (Treasurer Br. 1, 8), but the Treasurer's proposal could produce just this result.

The Treasurer's argument effectively amounts to a proposal for new legislation, an argument better directed to the legislative branch rather than to this Court. In any event, the record in this case establishes that the Treasurer's proposed tests were satisfied.

There is nothing in the record to suggest, and the Treasurer does not argue, that the Contingent Loan Agreement was not an arm's-length

transaction, so the first prong of the Treasurer's proposed test is satisfied.[4] The second prong is satisfied because the record, as well as the Washington State Auditor's Financial Statement Audit Report ("Audit Rpt.") [5], demonstrate that an analysis of the income that could be expected from Regional Center operations and tax receipts was performed by independent consultants, and it was reasonably expected at the outset of the transactions relevant to this appeal that the income from the Regional Center would be sufficient to meet operations and maintenance costs and debt service.

Specifically, in 2006, before the Regional Center was built, an independent consultant estimated that $2.4 million would be available annually to meet debt service obligations. (Audit Rpt. at 2). At that time, the City and the District anticipated that District revenues would be sufficient to make required debt service payments. (CP 838). And when the 2008 Bond Anticipation Notes were issued, the District estimated that

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[4] Nonetheless, the District believes the Treasurer's proposal to require "arm's-length" transactions may be problematic. Many municipalities routinely loan or transfer funds from one fund under the municipality's control to another, and this Court has regularly approved such transactions even though the transactions are not "arm's-length" in the usual sense. Such intra-government transactions were at issue in, for example, *Comfort* and *Von Herberg v. City of Seattle*, 157 Wn. 141, 288 P. 646 (1930).

[5] The Audit Report is attached as Appendix A to Vancouver's brief. The Audit Report was not part of the record on summary judgment below (CP 663-64) and, therefore, is not properly part of this appeal. RAP 9.12. To the extent the Court elects to consider the Audit Report, the District provides further analysis for a full appreciation of the Report's findings.

between $1.8 and $2.7 million would be available for debt service annually between 2008 and 2013. (CP 327).[6]

When the District and the City entered into the 2006 Interlocal Agreement, in which the City committed to enter into one or more contingent loan agreements with the District to provide loans from the City if the District had insufficient funds to meet semi-annual debt service payment obligations, (*see* App. Br. 7-8), the expectation was that the District would generally have adequate funds available to meet its debt service obligations. (CP 838). Thereafter, exercising its right to request contingent loan agreements from the City, the District twice entered into contingent loan agreements without controversy. (App. Br. At 9, 14 n. 5).

As the Regional Center construction was completed in the autumn of 2008, the District was required to finance acquisition of the Center. But this coincided with the extreme turmoil in the financial markets in 2008, and the District used a short-term financing mechanism, the 2008 Bond Anticipation Notes, rather than long-term financing, as means of coping with extreme market conditions. It was not until 2011, years after the original projections about the Regional Center's likely financial performance were made in 2006, and nearly two years after the District

[6] This would be sufficient to pay the $2.4 million in annual debt service obligations Vancouver estimates would be required if the District issued 25-year bonds at a 5% interest rate. Vancouver Br. 7 n. 11.

first learned in May 2009 that those financial projections were not met in the Center's initial months of operation (Audit Rpt. at 2), that the City questioned the legality of the *obligation it assumed in 2006* to enter into contingent loan agreements to support the District's financing of the Regional Center. As the City stated below:

> At the time the City executed the September 2006 Interlocal Agreement – in which it committed to provide security for the Bonds and to do so through an agreement to pay the principal and interest on the Bonds to the extent the District cannot do so from its own revenues – the City and the District anticipated that the District's revenues would be sufficient to make the required debt service payments. As such, it was not anticipated at that time that the City would be called upon to make loans . . . It is only changed circumstances, namely the failure of the Regional Events Center to generate the anticipated revenues, that has caused the City to question whether executing the proposed 2011 [Contingent Loan] Agreement at this time would create a Debt of the City. (CP 838).

In short, it is clear that, when the commitments to build and finance the Regional Center were made in 2006, the District and the City acted on the basis of the kind of up-front estimates that the Treasurer would require. The law should not be construed to allow municipalities to undo these kinds of financial commitments when circumstances, such as the "Great Recession" that began in 2008, arise that prevent earlier projections from being realized.

D. There Is Nothing in the Record Demonstrating That The Regional Center's Initial Disappointing Results Will Continue Indefinitely Into the Future.

Relying on the Washington State Auditor's Audit Report attached to its brief, Vancouver makes much of the District's disappointing financial performance to date. (Vancouver Br. 6-8). But nothing in the Audit Report supports the inference that the Regional Center's financial performance to date will continue indefinitely into the future. On the contrary, as the record demonstrates (CP 545-46), the District's financial performance has steadily improved. (Audit Rpt. at 3). This is in part because the District has undertaken a number of initiatives to improve the Center's performance, such as terminating the initial management contract and hiring an internal general manager. (Audit Rpt. at 14).[7] In addition, the District is seeking long-term solutions such as an increase in the sales tax available to the Regional Center. (Audit Rpt. at 5, 14). In short, as the District has maintained throughout this appeal, there is no support in the record for the proposition that the Regional Center's disappointing financial performance will continue indefinitely.

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[7] Vancouver repeats the Auditor's finding that the District has not generated sufficient revenue "*through operations*" to cover operating expenses and debt service. Vancouver Br. at 13 n. 7 (emphasis added). But it was never contemplated that the Regional Center would be self-supporting based on operating revenues alone. To the contrary, it was anticipated that revenues to support debt service would come from both operating revenues and tax revenues. CP 327.

E. If New Rules Are Adopted, This Court Should Adopt Them On A Prospective-Only Basis.

This Court should adhere to long-established Washington law that debt requires: (1) borrowing; (2) an obligation that is not contingent; and, (3) a pledge of future taxes for repayment. There is no need to depart from Washington's clear rules on these subjects.[8] In particular, Washington's bright-line rules regarding contingent obligations are not in need of reform.

If, however, the Court elects to adopt new rules in the area of contingent obligations as urged by Amici or as adopted by the trial court, it is clear that such rules would depart substantially from the law as it existed at all times relevant to this appeal. Accordingly, this Court should apply any such ruling on a prospective-only basis. *Lunsford v. Saberhagen Holdings, Inc.*, 166 Wn.2d 264, 281, 208 P.3d 1092 (2009) (holding that a "case announcing the new rule of law" can be applied on a prospective-only basis).

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[8] As this Court recently noted:

> "[O]verruling prior precedent should not be taken lightly." *Lunsford v. Saberhagen Holdings, Inc.*, 166 Wash.2d 264, 278, 208 P.3d 1092 (2009). We will not overrule a precedent unless there is " 'a clear showing that an established rule is incorrect and harmful.' " *Id.* at 280, 208 P.3d 1092 (internal quotation marks omitted) (*quoting Riehl v. Foodmaker, Inc.*, 152 Wash.2d 138, 147, 94 P.3d 930 (2004)).

Hardee v. DSHS, 172 Wn.2d 1, 15, 256 P.3d 339 (2011).

Each of the three factors relied upon by this Court in determining that a newly-announced rule of law should be applied only prospectively is met here. *Lunsford,* 166 Wn.2d at 271-72 (*citing Chevron Oil v. Huson,* 404 U.S. 97, 106-07 (1971)). First, as discussed above, adopting either of the tests proposed by Amici would result in adoption of a new rule of law that is neither consistent with existing precedent concerning contingent obligations nor clearly foreshadowed.

Second, retrospective application of the new test would not further the purposes of the new rules proposed by Amici, which are intended to provide greater clarity to Washington governmental authorities and to financial markets in the application of the law regarding contingent obligations. Retroactive application of these new rules will result only in defeating the settled expectations of the District and its member governments, who relied on the state of the law as it existed in 2006 when they elected to go forward with construction of the Regional Center, as well as the expectations of purchasers of the 2008 Bond Anticipation Notes, who similarly relied on the law as it existed in 2008 when purchasing those Notes. An uncured default on the 2008 Notes, and the inevitable resulting protracted litigation, will not promote the policy purposes of the new rules proposed by Amici. Nor will retroactive application of the new rule provide a remedy for an injured party. *See*

Taskett v. KING Broadcasting Co., 86 Wn.2d 439, 450, 546 P.2d 81 (1976) (concluding that retroactive application is justified to provide remedy for victim of defamation).

For similar reasons, the third element in *Lunsford* is met, because retroactive application of Amici's proposed new rules would be inequitable for the District and the purchasers of its 2008 Notes who relied on the state of the law at the time the economic decisions underlying this appeal were made. *See Lunsford*, 166 Wn.2d at 272-73 (noting that justifiable reliance is the primary factor in determining whether a new judicial ruling should have prospective-only effect).

This Court has, in similar circumstances, recognized the importance of settled expectations arising in the context of government bond financing, and applied a newly-announced rule on a prospective-only basis. In *State ex rel. Washington State Finance Commission v. Martin*, 62 Wn.2d 645, 384 P.2d 883 (1963),[9] this Court announced a new rule which departed substantially from the law relevant to constitutional debt limitations as it existed prior to that case. In order to protect the settled expectations of both government entities and bond investors on the previously-applicable rule, this Court determined that the new rule should

[9] *Martin* is one of the precedents extensively relied upon by this Court in *Lunsford*. 166 Wn.2d at 270-83 & nn.7, 10 & 12.

be applied on a prospective-only basis. 62 Wn.2d at 663-74. If this Court elects to adopt the new rules suggested by Amici, or to apply the trial court's definition of "debt," such a decision should be applied on a prospective-only basis.

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III. CONCLUSION

Washington law makes clear that "debt" requires borrowing, and that contingent liability is not "debt." Washington law is equally clear that contingent obligations do not become non-contingent definite obligations until the relevant contingencies (here, the amount and timing of loans) are triggered. Because the relevant contingencies have not yet triggered in this case, the trial court's decision was error and should be reversed. There is no reason to adopt the new rules regarding contingent liabilities suggested by Amici.

RESPECTFULLY SUBMITTED this 30th day of December, 2011.

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No. 86552-3

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BOND ISSUANCE OF GREATER WENATCHEE
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GREATER WENATCHEE REGIONAL EVENTS CENTER
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CITY OF WENATCHEE, WASHINGTON,

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Karen Lang Crane certifies under penalty of perjury under the laws of the State of Washington:

1. I am a citizen of the United States, and I am now and was at all times material hereto over the age of 18 years. I am employed by Gordon Thomas Honeywell LLP, attorneys for the Appellant in this action, and make this declaration based upon my personal knowledge of the facts stated below. I am not a party to the above entitled action and am competent to be a witness herein.

2. On the 30th day of December, 2011, I caused to be served true and correct copies of the Answer of Appellant to Briefs of Amicus Curiae and this Certificate of Service on counsel of record as noted below:

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DATED this 30th day of December, 2011, in Seattle, Washington.

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December 30, 2011

Via Email

Ronald R. Carpenter
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RE: **Supreme Court Cause No. 86552-3 - In Re Bond Issuance of Greater Wenatchee Regional Events Center Public Facilities District**
Chelan County Superior Court Cause No. 11-2-00737-0

Dear Mr. Carpenter:

Enclosed for filing in this case, please find the Answer of Appellant to Briefs of Amicus Curiae and Certificate of Service, which are being filed in accordance with the Court Commissioner's Order of December 22, 2011, setting the date for filing answers to the briefs of amicus curiae.

Thank you.

Sincerely,

GORDON THOMAS HONEYWELL LLP **OGDEN MURPHY WALLACE, PLLC**

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